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TAGS: ECON EFIN PREL EI
SUBJECT: THE IRISH ECONOMY -- ON A SLIPPERY SLOPE

REF: DUBLIN 416

Classified By: PEO Chief Ted Pierce. Reasons 1.4 (b/d).

¶1. (C) Summary: The slumping Irish economy and reduced government tax take have compelled Prime Minister Brian Cowen to advance the 2008 budget by two months. Sharp spending cuts are likely. However, it is unclear how far the Irish government will go to reverse the slide of the economy. Irish macroeconomic stability and growth is a major reason U.S. businesses have invested so much here. These companies will be watching the government's policy response as carefully as local business. End Summary.

¶2. (U) Following bad news on tax receipts and unemployment, the Irish government announced September 4 that it will deliver next year's budget on October 14, 2008 -- two months earlier than the traditional December timeframe. The 2008 government revenue shortfall will surpass USD 7.5 billion. In July the Irish government predicted a deficit of USD 4.5 billion (Reftel) but a sharper than expected contraction in economic activity has put a further dent in its finances. Since July most forecasters have revised their estimates for 2008 GDP growth downward and are predicting negative growth for the first time since the late 1980s. In addition, the unemployment rate has edged up to 6.1 percent, the first time it has exceeded six percent since January 1998.

¶3. (U) In the government's September 4 statement Finance Minister Brian Lenihan noted that the government will "stabilize and restore balance to the public finances by, among other things, prioritizing current and capital public expenditures to reflect changed realities." The statement also points out that Ministers are assessing their Ministries' budgets and prioritizing spending that will encourage "investment and activity and deepen Ireland's competitiveness." The government notes that rising domestic prices are eroding Ireland's competitiveness.

¶4. (C) Department of Finance officials Econoff spoke to had little to say. Both Robert Watt (Assistant Secretary at Finance) and Kevin Cardiff (Second Secretary General) had little information they could share with us. Watt noted in a pro-forma manner that, "government officials are responding to new fiscal data available to them, and will take whatever steps are required to stabilize public finances." Cardiff only added that he and his colleagues would be working a lot of overtime trying to put together the budget two months ahead of schedule.

¶5. (C) Private-sector economists on the other hand told Econoff they viewed the Government's response positively but admitted that there are tough decisions ahead. Austin Hughes, Chief Economist at IIB Bank, said that he was optimistic that the government's announcement would boost confidence but that for the boost to stick "there has to be a credible move in public finances and a reassessment of capital spending." Jim Power, Chief Economist at Friends First, echoed these sentiments adding that getting a handle on public sector spending is a crucial component of any

solution. He continued, however, that holding the line on spending will be extremely difficult as the government is in the middle of negotiating a new public sector pay deal; the so-called Social Partnership.

¶6. (C) Comment: With slowing domestic economic activity causing a falling tax take, no monetary tools to speak of, and a sluggish global economy, the Irish government's only credible policy response is to cut spending. The bold move would be for the government to strike at the well-entrenched bureaucracy and cut public sector payrolls and benefits. However, officials may take the easy route and cut long-term capital expenditure or some other spending that does not have a constituency. Either way Budget Day in October promises to offer a glimpse at how far the Cowen government is willing to go to create a more competitive Irish economy. U.S. businesses -- attracted by the macroeconomic stability here -- will be watching the policy response closely. End Comment.
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